

Message Text

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44

ACTION NEA-10

INFO OCT-01 ISO-00 ABF-01 FS-01 AID-05 CIAE-00 COME-00

EB-07 FRB-03 INR-07 NSAE-00 USIA-06 TRSE-00 XMB-02

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R 191132Z APR 76

FM AMEMBASSY NEW DELHI

TO SECSTATE WASHDC 5342

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FOLLOWING SENT ACTION NEW DELHI INFO CALCUTTA, MADRAS FROM
BOMBAY APRIL 13, 1976 REPEATED FOR YOU

QUOTE

BOMBAY 0947

EO 11652: NA

TAGS: EFIN IN

SUBJ: ADJUSTMENT IN FOREIGN EXCHANGE VALUE OF THE RUPEE

1. BOMBAY FINANCIAL CIRCLES WERE MILDLY SURVKHULN BY APRIL 12
CHANGE IN RESERVE BANK OF INDIA(RBI) APPROACH TO ADJUSTING
FOREIGN EXCHANGE VALUE OF THE RUPEE IN THE LIGHT STERLING'S
COTINUING DECLINE. MOST FINANCIAL PEOPLE HERE HAD ASSUMED THAT
RBI WOULD CONTINUE TO REVALUE RUPEE UPWARD IN TERMS OF STERLING
EACH TIME THAT STERLING SLIPPED ABOUT 2PC ON THE AVERAGE AGAINST
OTHER MAJOR CURRENCIES. THIS APPROACH, OF COURSE, WOULD HAVE
CONTINUED THE PATTERN ADOPTED LATE LAST YEAR AND FOLLOWED AS
RECENTLY AS APRIL 3 AND APRIL 7 IN REVALUATIONS OF THE RUPEE
AGAINST STERLING. IN EFFECT, SINCE THE BASKET OF CURRENCIES
APPROACH SET IN SEPTEMBER 1975 RBI HAS ADJUSTED RUPEE ANYTIME ITS
TIE TO STERLING CAUSED CHANGE IN ITS VALUE IN TERMS OF DOLLAR,
MARK, SWISS FRANC, GUILDER, OF MORE THAN TWO PERCENT.

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2. ON APRIL 12, HOWEVER, THIS PATTERN BROKEN WHEN RBI LET THE RUPEE CONTINUE TO SLIDE DOWNWARD WITH THE POUND BY CHANGING THE RUPEE DR RATE IN THE SAME PROPORTION AS THE POUND DEPRECIATION AGAINST THE SDR UNIT SINCE APRIL 7, OR ABOUT 1.5PC.

3. LOCAL OBSERVERS NOTE THAT THE RBI INTERVENTION OCCURRED SOONER THAN THE RECENT PATTERN WOULD HAVE DICTATED AS THE STERLING LOSS AGAINST THE DOLLAR HAD AMOUNTED TO NEARLY 1.5PC WHILE RECENT ADJUSTMENTS HAD OCCUREED ONLY AFTER MOVEMENTS AMOUNTED TO 2 PC. THEY INTERPRET THIS SPEEDIER ACTION AS REFLECTING A DESIRE ON THE PART OF THE RBI TO ENDORSE SOME DEVALATION OF THE RUPEE AGAINST NON-STERLING MAJOR CURRENCIES, BUT NOT ALLOWING THIS CHANGE TO ASSUME LARGER PROPORTION.

4. INDIAN MONETORY AUTHORITIES HAD BECOME INCREASINGLY CONCENRED IN RECENT WEEKS OVER THE NEED FOR PERIODIC REVALUATIONS OF THE RUPEE AGAINST STERLING. THEY FOUND THAT THESE CHANGES WERE BEING ANTICIPATED BY THE MARKET. EACH TIME THE COMMERCIAL BANKS SELLING RATE FOR DOLLARS EXCEEDED RS. 9 THERE WAS A FLURRY OF ACTIVITY AS THE MARKET ANTICIPATED A CHANGE IN THE RUPEE RATE TO PREVENT THE RUPEE FROM BEING DRAGGED DOWNWARD BY ITS TIE THROUGH THE INTERVENTION DEVICE WITH STERLING. THE VERY PREDICTABILITY OF THIS OPERATION WAS VIEWED IN THE RBI AS BEING DESTABILIZING IN THE EXCHANGE MARKETS AS IT STIMULATED ACTIVITY THAT WAS TO SOME EXTNET SPECULATIVE.

5. IN COMMENTS TO THE CONGEN ON APRIL 9, J.C.LUTHER, WHO NOW CLAIMS TO BE IN CHARGE OF THE RBI FOREIGN EXCHANGE AND BANKING OPERATIONS, ADMITTED THAT THE STERLING SLIDE WAS POSING SOME DIFFICULT CURRENCY MANAGEMENT PROBLEMS FOR THE RBI. HE SAW TWO MAIN DIFFICULTIES: THE DESTABLIZATION EFFECT NOTED ABOVE AND THE PROBLEM OF MAINTAINING SALES IN STERLING MARKETS IN VIEW OF CONTINUING APPRECIATION OF THE RUPEE IN TERMS OF STERLING. HE VIEWED THE LATTER PROBLEM AS ESPECIALLY SERIOUS, EVEN THOUGH TOTAL INDIAN SALES IN THE STERLING AREA NOW AMOUNT TO ONLY 20-25PC OF INDIA'S EXPORTS. HE SAID THESE SALES TEND TO BE CONCENTRATED ON PRODUCTS LIKE TEXTILES WHERE THE INDUSTRY REMAINS DEPRESSED.

6. LUTHER POINTED THAT WHEN THE CURRENCY BASKET APPRACH WAS INTRODUCED LAST YEAR, THE INTENTION WAS TO GIVE THE RBI MORE LIMITED OFFICIAL USE

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FLEXIBILITY IN ADJUSTING THE RUPEE'S FOREIGN EXCHANGE VALUE TO CHANGING INTERNATIONAL CONDITIONS. STERLING'S FALL IN THE PAST MONTH HAD BEEN SO PRECIPITOUS THAT THE BANK WAS FORCED TO ACT QUICKLY BUT WITH LITTLE OPPORTUNITY TO GAUGE THE FULL RANGE OF ALTERNATIVES OPEN TO IT. THERE WAS A DESIRE TO DEMONSTRATE TO THE MARKET THAT THERE WOULD BE NO AUTOMATIC REVISIONOF THE RATE TO OFFSET DECLINE IN STERLING. THERE WAS HESITATION TO DEVALUE THE RUPEE AGAINST OTHER MAJOR CURRENCIES AT A TIME WHEN INDIA'S

FOREIGN EXCHANGE RESERVES WERE RISING TO AN ALL-TIME PEAK. NEVERTHELESS, HE FELT THAT THE ONLY REAL ARGUMENT AGAINST SUCH A MOVE WAS THAT DEPRECIATION OF THE RUPEE AGAINST MOST MAJOR CURRENCIES WOULD HAVE SOME DOMESTIC INFLATIONARY IMPACT WHICH THE GOVERNMENT DID NOT WANT. ON THE OTHER HAND, EXPORT-ORIENTED INDUSTRIES, PARTICULARLY IN LIGHT ENGINEERING HAD FOUND THAT THE PRICE STABILITY IN INDIA OVER THE PAST YEAR HAD GIVEN THEM A COMPETITIVE ADVANTAGE IN FOREIGN MARKETS WHICH COULD BE ENHANCED BY A MODEST DEVALUATION OF THE RUPEE. THUS A DEVALUATION OF THE RUPEE COULD STIMULATE THE USE OF SUPPLIER INDUSTRIAL CAPACITY.

7. THE CONGEN BELIEVES THAT THE RBI (OR MORE EXACTLY GOI ACTING THROUGH RBI) CONCLUDED THAT THERE WAS SCOPE FOR A MORE ADVENTUROUS DEPARTURE IN ITS APRIL 12 ADJUSTMENTS OF THE FOREIGN EXCHANGE VALUE OF THE RUPEE. THEY HOPED TO PRESERVE THEIR MARKETS IN THE STERLING AREA BY HOLDING THE RUPEE-STERLING RATE AND AT THE SAME TIME BOOST THE STIMULUS PROVIDED TO INDIAN ENGINEERING INDUSTRY BY THE RECENT PRICE STABILITY IN INDIA WHILE INFLATION HAS CONTINUED IN MOST MAJOR INDUSTRIAL MARKETS. AT THE SAME TIME THE RBI SOUGHT THE TECHNICAL ADVANTAGES OF AVOIDING WHAT IT WAS COMING TO REGARD AS DESTABILIZING INFLUENCE IN INDIA'S FOREIGN EXCHANGE MARKETS BY THE VERY PREDICTABILITY OF FREQUENT AND ALMOST AUTOMATIC ADJUSTMENTS OFFSETTING DECLINES IN STERLING. THE COST IS IN TERMS OF MODERATE INFLATIONARY INCREASES IN RUPEE PRICES OF IMPORTS FROM STRONG CURRENCY COUNTRIES. MOST OBSERVERS HERE BELIEVE THAT THE LATEST MOVE IS EXPERIMENTAL AND SHOULD NOT BE REGARDED AS A NEW PATTERN AT LEAST UNTIL ITS EFFECTS ARE FULLY EVALUATED. SIGNED COURTNEY
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